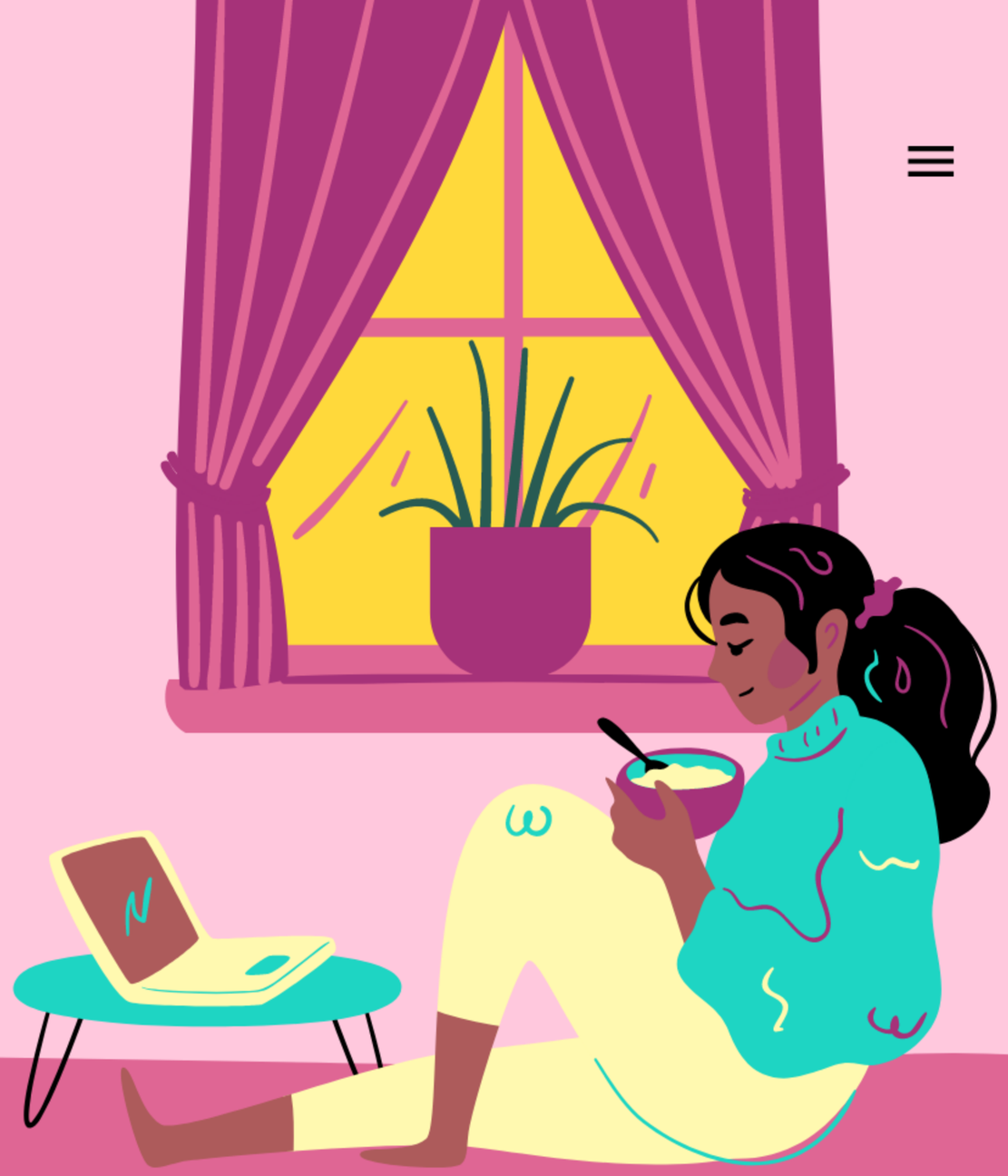
CHAPTER 4

APPLICATION OF SUPPLY AND DEMAND

Applied Economics



LEARNING OBJECTIVES

At the end of this chapter, the learners will be able to:

- explain the law of supply and demand;
- discuss and explain factors affecting supply and demand;
- compare the prices of commodities and analyze the impact on consumers;
- explain market structures and uses of money; and
- understand the labor market and labor supply.

THE LAW OF SUPPLY AND DEMAND

To an economist, the term DEMAND is very different from the terms need and want.

DEMAND

- is the **willingness and ability** of consumers to *buy products* at certain prices over a certain period.

- is a concept that relates the desire people have for goods and services to the sacrifices (costs) they are willing to make to get them.

NOTE: Needs and desires are subjective and are very difficult to measure. Demand, however, can be quantified.

THE LAW OF DEMAND

- states that there is a relationship between the price of a good and the amount of it that people are willing and able to buy.

- stipulates an inverse or negative relationship between the price of any good and the quantity that people will
buy.

Always remember!

In the law of demand, price is the cause and quantity is the effect. It means that when a price goes up, the quantity demanded goes down. On the other hand, when the price falls, the quantity demanded goes up.

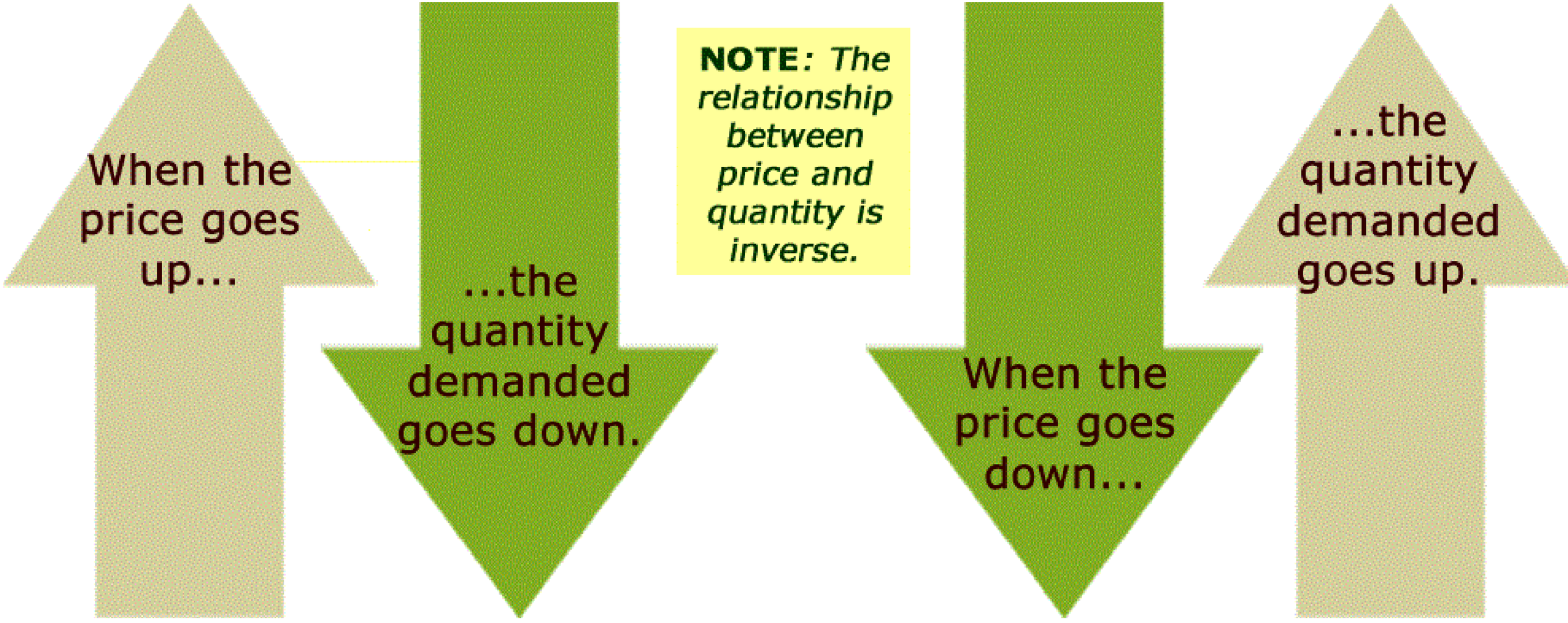
PRICE CAUSES THE CHANGE.

In Mathematical terms, **price** is the ***independent variable*** and **quantity** is the ***dependent variable.***

Of course, this discussion assumes...

Ceteris Paribus - which means that everything else stays the same and that price is the only thing that changes.

Law of Demand


When the price goes up...
...the quantity demanded goes down.
NOTE: The relationship between price and quantity is inverse.
When the price goes down...
...the quantity demanded goes up.

SUPPLY

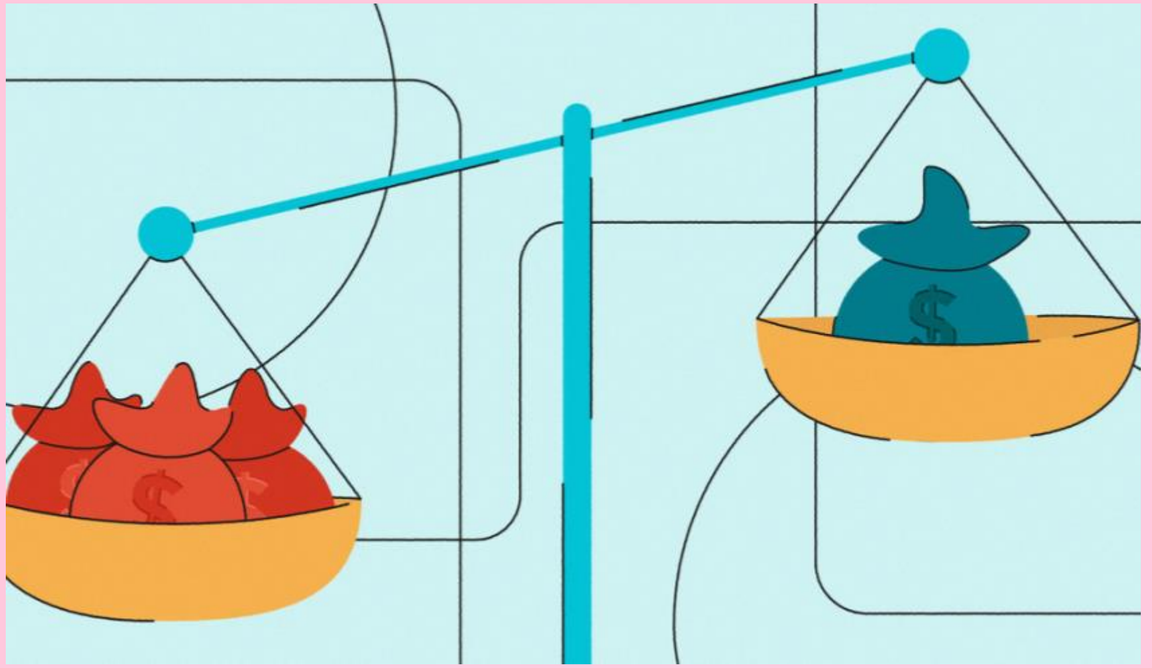
- Is the willingness and ability of a producer to make goods and services available at a variety of costs.

- In supplying goods to someone else, a business incurs costs, and it wants to get as much as it can from the sale to cover its costs and have something left over at the end of the day.

OPPORTUNITY COST

- the cost a producer faces

- producing more of one thing means giving up the opportunity to produce something else and using resources or inputs as well.



THE LAW OF SUPPLY

- The combination of price and costs

- States that there is a relationship between the price of a good and the amount that people are willing to spend and able to produce it.

HOW DOES IT WORK?

THE LAW OF SUPPLY

When the price that suppliers can receive for a **product increases**, they are willing to produce more of that product. On the other hand, when the price that suppliers can receive for a **product decreases**, they are less interested in producing that good. This is how suppliers express their own self-interest, and it is known as **law of supply.**

The Law of Supply

- According to the law of supply, the higher the price, the larger the quantity produced.